Supreme Court, U.S.
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No. 01-

IN THE

Supreme Court of the United States

JOHN N. BAIN and JOHN G. GILFILLAN, III,

Petitioners,

v.

FREDERICK F. BUECHEL, M.D., *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE COURT OF APPEALS, STATE OF NEW YORK

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

For five years, Respondents pursued a claim against Petitioners' former law partner seeking to terminate *ab initio*, as contrary to the public policy of New York as defined by its case law and attorney's code of ethics, the former partner's interest in two trusts arising from a contingent equity fee agreement expressly authorized for patent practitioners by federal law (37 C.F.R. § 10.64). On the eve of trial in that action, the trial court denied Respondents' last-minute motion to amend their pleading to bring the same claim against Petitioners. Respondents subsequently filed this action, and after obtaining a favorable judgment against Petitioners' former partner, persuaded the trial court to (a) exercise jurisdiction over Petitioners and (b) summarily bind Petitioners to the prior judgment without trial, notwithstanding the court's denial of Respondents' motion to bring a claim against Petitioners in the prior action.

I. Does 28 U.S.C. § 1338 and the Supremacy Clause preclude a state court from exercising jurisdiction over a civil action to rescind an equity fee agreement expressly authorized by federal patent law and preempt the application of conflicting state law to find the agreement invalid?

II. Did the New York Court of Appeals infringe Petitioners' procedural due process rights by binding them to a judgment in a prior action in which they were expressly relieved of liability by court order?

PARTIES TO THE PROCEEDINGS BELOW

The parties before the New York Court of Appeals were Petitioners John N. Bain and John G. Gilfillan, III, who are the defendants in a suit brought by Respondents Frederick F. Buechel and Michael J. Pappas. The law firm of Carella, Byrne, Bain, Gilfillan, Cecchi, Stewart & Olstein was named as a defendant, and R. Gale Rhodes, Jr. and Paul A. Witte were named as defendant-beneficiaries of a certain trust entitled Biomedical Engineering Trust in the suit below, but they were not parties to the appeal below to the New York Court of Appeals.

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John N. Bain and John G. Gilfillan, III respectfully petition for a writ of certiorari to review a decision of the Court of Appeals of the State of New York (the "Court of Appeals").

OPINIONS BELOW

The decision of the Court of Appeals is reported at 2001 WL 1636938 (N.Y. Dec. 20, 2001). The decision of the New York Appellate Division, First Department is reported at 275 A.D.2d 65, 713 N.Y.S.2d 332 (N.Y. App. Div. 2000). The decisions of the New York Supreme Court, New York County are unreported. Copies of all decisions are in the Appendix.

STATEMENT OF JURISDICTION

The Court of Appeals entered its decision on December 20, 2001. This Court has jurisdiction under 28 U.S.C. § 1257(a).

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS INVOLVED

The issues in this case implicate the Supremacy Clause, the Fourteenth Amendment of the United States Constitution, 28 U.S.C. § 1338 and 37 C.F.R. § 10.64. Excerpts of these provisions are set forth at App. 154a-155a.

STATEMENT OF THE CASE

This case concerns the validity of a set of fee arrangements by which Petitioners, two New Jersey patent lawyers, received a proprietary interest in certain patents as the fee for prosecuting those patents on behalf of Respondents, two New Jersey inventors. Accepting equity in those patents in lieu of a cash fee is expressly permitted, and indeed encouraged, by the code of professional responsibility issued by the United States Patent and Trademark Office (the "PTO Code"), which regulates the practice of patent law. *See* 37 C.F.R. § 10.20, *et seq*. Far from recognizing the supremacy of federal regulation of patent practitioners' equity fees, the New York courts ruled that these two New Jersey patent lawyers are subject to New York's Code of Professional Responsibility (the "New York Code"), imposing far-reaching burdens on the acceptance of equity fees found nowhere in the PTO Code. Indeed, the New York courts not only improperly applied New York law to an area preempted by

federal regulations, but they had no subject matter jurisdiction to consider the validity of these equity fee agreements in the first place. That question is the subject of exclusive federal jurisdiction under 28 U.S.C. § 1338(a).

Compounding their jurisdictional and preemption errors, the New York courts never gave Petitioners any opportunity to defend their fee agreements in any forum. Rather, the New York courts applied preclusion principles offensively to estop Petitioners from mounting any defense whatsoever to the claims asserted against them. The courts below ruled that Petitioners are bound to a decision issued, not against them, but against a different person, at a prior trial, notwithstanding the prior court's express ruling that Respondents could not assert such claims against Petitioners in that action. The New York court's radical extension of the doctrine of offensive collateral estoppel to preclude Petitioners from defending themselves is a manifest due process violation.

A. Procedural History

(1) The Prior Action

In 1987, Petitioners' former law partner, R. Gale Rhodes, Jr., commenced an action in New York Supreme Court against Respondents as trustees of two trusts ("Trust I" and "Trust II," respectively), the corpuses of which were patents covering prosthetic devices Respondents had invented (the "*Rhodes* action"). App. 3a. Rhodes' complaint pertained exclusively to Respondents' alleged misconduct as trustees of Trust I. App. 3a, 44a-45a. Rhodes charged that Respondents had unlawfully diverted trust income for their own personal interests and sought an accounting and to remove them as trustees. App. 3a, 44a-45a. In addition to acting as trustees, Respondents each held a one-third beneficiary interest in both trusts. App. 2a-3a. Petitioners and Rhodes each held a one-ninth beneficiary interest in Trust I. App. 2a.[1]

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1. Rhodes, but not Petitioners, was also a beneficiary of Trust II. App. 2a-3a.

Pursuant to New York procedural rules, Rhodes joined Petitioners as "defendant-beneficiaries" in the *Rhodes* action in response to Respondents' motion to dismiss for failure to join a necessary party. App. 19a, 50a-51a. Petitioners, however, did not participate in that lawsuit, and Rhodes never asserted claims for relief against them. App. 3a, 19a, 45a.

Some four years after Rhodes initiated suit, Respondents, as individuals and not as trustees, interposed five counterclaims solely against Rhodes. App. 3a, 19a. Their third counterclaim – which is the only counterclaim on which they were awarded judgment – sought rescission *ab initio* of only *Rhodes'* interest in Trust I, on the ground that by taking an equity interest in the patents held in trust Rhodes had violated New York law pertaining to attorney ethics. App. 3a, 19a, 97a, 98a, 152a. Respondents specifically excluded any effort to rescind Petitioners' interest.

Four years later (or nearly eight years after the *Rhodes* action commenced), Petitioners questioned certain of Respondents' conduct as trustees. Respondents retaliated by firing them as counsel. Then, on the eve of trial in the *Rhodes* action, Respondents moved to amend their counter-complaint to assert claims for the first time against Petitioners. App. 4a, 19a. The *Rhodes* court denied Respondents' belated motion, concluding that adding Petitioners as counterclaim-defendants on the eve of trial would have resulted in undue prejudice either to Rhodes (if trial was delayed to allow Petitioners to take discovery) or to Petitioners (if they were denied discovery). App. 73a. Although permitted an interlocutory appeal under New York law, Respondents elected not to appeal or even to move to vacate or reconsider that order. Instead, on March 21, 1995, before the *Rhodes* trial had begun, Respondents brought this separate action against Petitioners, which was stayed while Rhodes' suit proceeded to trial. App. 5a, 20a.

After a bench trial in which Petitioners did not participate, the trial court issued a judgment in favor of Respondents on their third counterclaim for rescission of Rhodes' interest in the

trusts. App. 120-121a.[2] The judgment was based exclusively on state law. Rhodes failed even to raise the defense that 37 C.F.R. § 10.64 governed or that federal jurisdiction was exclusive.

B. The Instant Action And The New York State Court Decisions

Following the decision in the *Rhodes* action, Respondents moved for summary judgment below, asking the trial court (and the same judge) to bind Petitioners to its prior decision in the *Rhodes* action and to terminate Petitioners' interest in Trust I. App. 56a, *et seq*. In response, Petitioners argued, *inter alia*, that to bar them from an opportunity to litigate the claims against them on the merits would infringe their due process rights as they were expressly excused from liability in the *Rhodes* action; in addition, Petitioners cross-moved for summary judgment on or about September 18, 1998. App. 56a, *et seq*. By memorandum decision dated May 26, 1999, the trial court held that Petitioners were bound by the *Rhodes* judgment under the doctrine of collateral estoppel by finding them in privity with Rhodes, notwithstanding that they had not been partners since 1981. The trial court thus terminated Petitioners' interest in the patents, and ruled that Petitioners had to repay all monies paid to them since 1974 (less a yet-to-be determined amount in *quantum meruit*). App. 64a-70a.[3]

Shortly thereafter, Respondents served an amended complaint. App. 61a. In lieu of answering, Petitioners moved to dismiss on the ground that this dispute over the validity of the

2. That judgment was affirmed by the New York Supreme Court Appellate Division. *Rhodes v. Buechel*, 685 N.Y.S.2d 65 (N.Y. App. Div. 1999). The New York Court of Appeals declined review.

3. Two issues remain before the trial court: (i) the calculation of the *quantum meruit* value of the legal services rendered by Petitioners; and (ii) a state law malpractice claim. This Court has jurisdiction under 28 U.S.C. § 1257 because the "the federal [jurisdictional and due process] issue[s], finally decided by the highest court in the State, will survive and require decision regardless of the outcome of future state-court proceedings." *Cox Broad. Corp. v. Cohn*, 420 U.S. 469, 479 (1975); *accord Radio Station WOW, Inc. v. Johnson*, 326 U.S. 120 (1945).

fee agreement arose under federal patent law, and therefore this action falls under exclusive federal jurisdiction pursuant to 28 U.S.C. § 1338. App. 60a, *et seq.*

On January 11, 2000, the trial court issued an order denying Petitioners' motion to dismiss for lack of subject matter jurisdiction on the ground that "[t]he interpretation of the patent law on issues of patent priority and infringement are hardly at issue in this action." App. 61a. On January 19, 2000, the trial court issued a second order applying the holding of its May 26, 1999 memorandum decision to the amended complaint and voiding Petitioners' equity fee agreement. App. 56a-58a.

On September 28, 2000, the New York Appellate Division (First Department) affirmed the trial court's orders, but on different grounds. App. 40a-55a. First, the court asserted jurisdiction over this action and the equity fee arrangement on the ground that the fee arrangement, although sanctioned by federal law, violated the "Canons of Ethics governing the practice of law in [New York]." App. 53a-54a.[4] On the due process issue, it reasoned that, because Petitioners had been joined as beneficiaries of Trust I, they had an affirmative duty to inject themselves into the *Rhodes* litigation in their personal capacities even though no claims for relief were pending against them. App. 48a-51a. Thus, it affirmed on the basis of party-preclusion (*i.e.*, claim preclusion/*res judicata*) rather than on the privity-preclusion theory (*i.e.*, issue preclusion/collateral estoppel) that the trial court had cited.[5]

In a split decision, the New York Court of Appeals affirmed. App. 1a-39a. On the jurisdictional question, the Court of Appeals found that the New York courts properly

4. Petitioner, Bain is not a member of the Bar of New York and does not practice law in New York. The Trust was executed in New Jersey between New Jersey lawyers and their clients, both of whom were residents of New Jersey, and performed by Petitioners in New Jersey.

5. The court held alternatively that Petitioners were in privity with Rhodes because they had once been law partners (until 1981) and because they appeared to share a mutuality of interests. App. 51a-53a.

exercised jurisdiction because (i) Respondents "did not plead any substantive questions of patent law as an element of claims asserted against Petitioners"; (ii) "this cause does not sound in patent law because the interpretation of the patent laws on the issues of priority and infringement are hardly at issue"; and (iii) notwithstanding that "[f]ederal patent law recognizes that attorneys may receive an interest in patents in lieu of traditional fee arrangements," the validity of such non-traditional arrangements does not obviate the need for the disclosure mandated by the New York Code. App. 14a (internal quotation marks and citation to trial court decision omitted).

On the preclusion issue, the Court of Appeals affirmed on the basis of privity-preclusion. It based its privity finding largely upon its determination that Petitioners' "rights to receive payment [under the fee agreement] were coextensive with Rhodes and derived from the identical arrangement" and its perception that their "interests were aligned with Rhodes with respect to the lawfulness of the fee arrangement." App. 10a.

In dissent, Judge Levine protested that the majority's opinion "offends traditional notions of due process guaranteeing that parties must have their day in court before their rights are adjudicated." App. 36a. Judge Levine explained that due process does not permit a party to be bound to an adverse ruling against a prior party merely because their rights were "coextensive, derived from the same source and 'aligned,' *i.e.*, substantially identical." App. 34a. The dissent criticized the majority's rationale as nothing more than an expansive form of privity based upon a theory of virtual representation or aligned interests that has been

expressly rejected by this Court[6] and by several federal circuits,[7] and criticized by commentators.[8] App. 36a-37a.

REASONS FOR GRANTING THE WRIT

The New York state court's decision to exercise jurisdiction over the fees charged by patent practitioners, and to apply its own public policy under case law pertaining to New York's ethical standards to supplant the explicit federal policy in the federal code governing the conduct of patent practitioners, poses problems of federalism of enormous significance to inventors and patent lawyers throughout the country. This Court has had occasion in the past to review, and reject, state-sponsored restrictions on federally-licensed and federally-regulated patent practitioners. *See Sperry v. State of Fla. ex rel. Fla. Bar*, 373 U.S. 379, 384 (1963). In this case, the New York courts have announced that fee arrangements explicitly authorized by federal law – that is, fees payable in the form of an equity interest in patents, rather than in hourly charges – are so "disfavored," and so encumbered by restrictions, disclosure requirements and "independent counsel" requirements, and so "dubious" and "suspi[cious]," as to be essentially impossible to use. App. 98a-102a.

There are approximately 27,000 patent practitioners in this country. Under 37 C.F.R. § 10.64, those practitioners (and their clients) are allowed to take advantage of alternative fee arrangements that may be unusual (or entirely improper) under a given state's laws applicable to state-licensed attorneys. Federal law does not view such arrangements "with suspicion," and does

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6. *See Richards v. Jefferson County*, 517 U.S. 793 (1996).

7. *See, e.g., Becherer v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 193 F.3d 415 (6th Cir. 1999) (en banc); *Tice v. American Airlines, Inc.*, 162 F.3d 966 (7th Cir. 1999).

8. *See, e.g.*, 18 WRIGHT & MILLER, FEDERAL PRACTICE AND PROCEDURE § 4457; R. Jason Richards, *Richards v. Jefferson County: The Supreme Court Stems the Crimson Tide of Res Judicata*, 38 Santa Clara L. Rev. 691 (1998); Jack L. Johnson, *Due or Voodoo Process: Virtual Representation as a Justification for the Preclusion of a Nonparty's Claim*, 68 Tul. L. Rev. 1303 (1994).

not consider them "of dubious propriety." Quite the opposite: these fee arrangements serve the federal purpose of facilitating counsel for inventors who lack the resources to pay in cash.

The New York rule set forth in this case makes it dangerous business indeed to agree to a contingent equity fee. Reading the trial court's excoriation of such arrangements – which was affirmed throughout the proceedings below – would discourage any prudent practitioner from entering into any such agreement. Patent practitioners and their clients now run the risk of having equity fees expressly authorized and encouraged by federal regulations, declared void *ab initio* by any one of 50 state courts. This can happen, and did happen here, after years of faithful performance, imposing retroactive liability on patent practitioners for monies paid years in the past. Worse, the state-court-imposed *requirements* of (a) retention of "independent counsel" for the inventor to represent him about the fee, (b) highly detailed and speculative written disclosures and (c) strict and highly skeptical scrutiny of such arrangements if litigation ensues, combine not just to discourage such fees, but to undermine their essential federal purpose even if they were to be used.

Further, only by engrafting state law onto the permissive federal rules did the state court exercise subject matter jurisdiction in the first place. Yet jurisdiction over disputes implicating the interpretation or application of the patent laws rests exclusively with the federal courts. *See* 28 U.S.C. § 1338(a). Patent practitioner ethics, the fees they can charge and fee structures they can utilize are governed by federal patent law. *See* 37 C.F.R. 10.20, *et seq*. Moreover, 37 C.F.R. § 10.64, which permits the very contingent fee arrangement in issue, expresses federal public policy to provide cash-starved inventors seeking patent protection with an alternative non-cash arrangement to secure competent representation from a federally licensed patent practioner. Disputes about the ethical propriety of such arrangements, are certainly claims "arising under any Act of Congress relating to patents." 28 U.S.C. § 1338(a).

For these reasons, the opinion of the New York Court of Appeals directly conflicts with opinions of both this Court and the federal circuit courts which uniformly hold that:

- States are preempted from regulating the practice of federal patent practitioners. *See Sperry*, 373 U.S. at 384; *Silverman v. State Bar of Tex.*, 405 F.2d 410, 411 (5th Cir. 1968).
- Any claim that rests on, or will survive or be defeated by, the interpretation of federal patent law and the PTO Code is subject to exclusive federal jurisdiction. *See, e.g., Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 808-09 (1988); *Helfgott & Karas, P.C. v. Dickerson*, 209 F.3d 1328, 1334 (Fed. Cir. 2000).

New York's assertion of jurisdiction over two New Jersey patent practitioners, its application of New York substantive law to their dispute with their clients and its effective abolition of contingent equity fees for inventors, plainly exceed the constitutional authority of any state court. Taken together, these holdings affect the daily professional lives of the entire federal patent bar, as well as the hundreds of thousands of individuals and companies who utilize their services.

The jurisdictional excesses of the state courts in this case have been compounded by their refusal to permit Petitioners even to present their case. Rather, Petitioners have been bound to a prior judgment rendered in an action involving their former law partner. This is so notwithstanding the fact that Petitioners *prevailed* in opposing a motion to amend to bring them into that prior action. This offensive use of preclusion doctrines has denied Petitioners their day in court even though, by receiving a court order entitling them *not* to appear in the prior action, an independent day in court was given an implicit but obvious judicial imprimatur. This separate day in court is exceedingly important here: Petitioners have available to them defenses not available to Rhodes, whose relationship with Respondents went

its own way during the *twenty years* since Rhodes ceased to be the partner of Petitioners.

Our research has revealed no case in which the party who prevailed in opposing a motion to amend a complaint has later been bound to the judgment in the case from which he was formally relieved of party status. Not in New York; not anywhere. The various holdings of the New York courts in this case on this subject – and they vary substantially from each other – have one thing in common: they all presume that despite prevailing on the motion to amend, Petitioners were obligated (on pain of having no hearing at all) to jump into the prior action anyway.

This is obviously an injustice.

One may argue, however, that this injustice is confined to its own unique facts and its own complex procedural history. Not so. In its ultimate formulation of the doctrinal basis for denying Petitioners their own day in court, the New York Court of Appeals has resuscitated a discredited view of the due process parameters of *res judicata* that permits litigation preclusion so long as the interests of the party to the second action are aligned with those of the party to the first action. Indeed, the Court of Appeals has adopted this view so strongly that it permits no exception for a party who was relieved of jeopardy in the first action by explicit court order.

It is this holding that poses grave constitutional dangers. It is this holding that is the main target of Justice Levine's 25-page dissent. And rightfully so. It has been clear for quite some time that due process prohibits a court from precluding a plaintiff from litigating his rights solely on the basis of an identity of interests with a prior litigant. *See Richards*, 517 U.S. at 799-805; *Becherer*, 193 F.3d at 424; *Tice*, 162 F.3d at 972. Rather, litigation preclusion principles have developed over time to assure that their anti-redundancy function is fulfilled within the due process imperative of assuring each independent party an independent right to present a case. The civil injustice done to Petitioners by precluding the presentation of their case will not be an isolated one under the New York standard.

This Court has spoken on each of these issues often in the past. We submit that the holdings below are sufficiently significant to warrant speaking once again.

I. The New York Court's Assumption Of Jurisdiction Over The Validity Of An Equity Fee Agreement Expressly Authorized By Federal Patent Law, And Its Imposition Of Conflicting Substantive State Law, Raise Major Legal Issues Affecting The Entire Federal Patent Bar

Congress has granted the federal courts original and exclusive jurisdiction over all claims "arising under any Act of Congress relating to patents." 28 U.S.C. § 1338. This Court has ruled that federal jurisdiction under Section 1338(a) extends to claims where (i) federal patent law creates the cause of action, or (ii) the plaintiff's right to relief necessarily depends upon a "substantial question of federal patent law," including where "some rights or interest will be defeated or sustained by a particular construction of federal patent law." *Christianson*, 486 U.S. at 808-09; *see also Helfgott & Karas*, 209 F.3d at 1334; *Franchi v. Manbeck*, 972 F.2d 1283, 1286 (Fed. Cir. 1992).

The validity of the fee agreement between Petitioners and Respondents, and therefore the proper disposition of Respondents' claim, can only be determined by reference to applicable federal patent regulations, 37 C.F.R. § 10.20, *et seq.*, which expressly authorize patent practitioners to accept an equity interest in a patent as part or all of their fee. *See id.* § 10.64.

Instead, the lower courts have imposed their own state law to encumber the federal standard to the point of eradicating it in practice. The trial court held in *Rhodes,* the decision to which Petitioners have been bound below, that contingent equity fees are so disfavored as a matter of New York law as to be virtually impossible to implement ethically. In contrast to the express authorization of such fees under 37 C.F.R. § 10.64 without encumbrances, and in derogation of the regulatory purpose that applauds such fees as encouraging representation of impecunious inventors, the trial court held:

- Equity fees are treated as a "transaction with a client" where there is always a real or latent "conflict of interest," and thus they are "presumptively void," of "dubious propriety," "regarded with suspicion," and generally "not advisable."
- Disclosure of potential conflicts of interest must be enormously detailed, and shall include notice of the "inherent" conflicts of interest, the "great potential for a lawsuit," loss of objectivity, the possibility of cash fee arrangements, the lawyer's profit motive, termination rights and more.
- Counsel must recommend that the client retain "independent counsel" to scrutinize the fee arrangements and "should insist" on the presence of "another lawyer."
- The burden of proving compliance with all of the foregoing is "squarely on the shoulders of the attorney."

App. 98a-102a. These holdings were applied in this case, and affirmed throughout. The New York courts have applied New York law to two New Jersey-based federal patent practitioners who represented New Jersey clients. This ruling poses a host of legal problems of national significance to the patent bar.

A. The Supremacy Clause Violation

The New York holdings conflict with federal law and public policy. By holding the equity fee agreement invalid under the New York Code, the Court of Appeals impermissibly circumscribed Petitioners' practice before the PTO and "impose[d] upon the performance of activity sanctioned by federal license additional conditions not contemplated by Congress." *Sperry*, 373 U.S. at 384.[9] The Supremacy Clause of

9. The goal of the patent system is to foster, reward and promote invention. *See Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 480-81 (1974). This objective is sometimes hindered by the prohibitive cost of (Cont'd)

the United States Constitution, art. VI, cl. 2, prohibits such state intrusion on federal power. *See Sperry*, 373 U.S. at 384; *Crosby v. Nat'l Foreign Trade Council*, 530 U.S. 363, 372 (2000).

An "attorney engaged in patent practice is obviously, inescapably, and inseparably performing within a field committed by the Constitution to the regulation of the general government." *Silverman*, 405 F.2d at 414. It is a legitimate objective of patent law to encourage the taking of an equity interest in a patent in lieu of a cash fee to reduce the barriers to obtaining patent counsel. *See supra* note 9; 37 C.F.R. § 10.64. The holdings below destroy that possibility.

As formulated by the trial court, the New York rules eviscerate the federal rules for all practical purposes. Few patent practitioners will risk fee agreements "of dubious propriety" that will be viewed with "suspicion" in court. Few clients who want or need a non-cash fee structure will hire "independent counsel" to negotiate with their patent counsel. The disclosures required are at least daunting, if not outright impossible to implement. The holdings below violate the Supremacy Clause and conflict with precisely formulated permissive federal regulations. They also intrude on a general field occupied by federal law (the 55-paragraph ethics code embodied by 37 C.F.R. § 10.20, *et seq.*), and the specific field of patent practitioner fee structures and management (37 C.F.R. § 10.64). These issues affect the entirety of the federal patent bar on a daily basis, along with all of the clients of that bar. The effect of the New York rule "is to deny a privilege entitled to federal protection," *Silverman*, 405 F.2d at 414, and to "hinder or obstruct the free

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(Cont'd)
actually obtaining a patent. For the inventor who would otherwise be thwarted, Congress – through the PTO – promulgated a solution, *i.e.*, Section 10.64. *See* 49 Fed. Reg. 33, 790, 33,798 ("There are inventors who would not be able to apply for a patent and secure the assistance of a registered practitioner unless the practitioner may take an interest in the patent as part or all of his or her fee. The text of proposed § 10.64(a) is being changed to permit a practitioner to acquire an interest in a patent case.").

use of a license granted under an act of Congress." *Sperry*, 373 U.S. at 385. The conflict between New York and federal law on this issue could not be more stark.

Decisions of this Court and the federal circuit courts uniformly reject state efforts to circumscribe the practice of patent practitioners. For example, in *Sperry*, the State of Florida charged a patent attorney with the unauthorized practice of law because he practiced patent law in Florida without also obtaining a state law license. *See id.* at 381. This Court held that because Congress had authorized the Commissioner of Patents to prescribe regulations governing the conduct of attorneys practicing before the Patent Office, the Supremacy Clause prohibited Florida from enforcing state licensing requirements that would have given it a power to review and override the federal determination authorizing Sperry to practice patent law. *Id.* at 383-85.

Likewise, *Silverman* concerned a Texas-licensed attorney registered to practice before the PTO. The State of Texas contended that he was bound by the Texas ethics rules when advertising his patent law practice in Texas. 405 F.2d at 411. Relying on *Sperry*, the Fifth Circuit held that an attorney engaged in patent practice is performing within a field the Constitution has placed under exclusive federal control and further ruled that, when performing patent-related activities, Silverman was bound solely by the PTO Rules which preempted otherwise applicable Texas rules. *Id.*

The plain rule flowing from these decisions is that state law and state courts may not circumscribe federally authorized patent lawyers from practicing patent law within their borders, including limiting the right to accept equity fees authorized by 37 C.F.R § 10.64. When Petitioners entered into an equity fee agreement with Respondents to provide services before the PTO, Petitioners were obligated to comply with the PTO Code only – and not the New York Code – in structuring that agreement.

The Court of Appeals never acknowledged, let alone addressed, *Sperry* or *Silverman*. Yet, the preemption in this case could not be more clear because the purported "ethical lapses"

are in reality simply a reflection of the explicit differences between federal public policy for patent practioners (who need not even be state-licensed lawyers) and New York State public policy. Thus, the New York court's holding cannot be reconciled with the decisions of this Court, or of the Fifth Circuit.[10]

B. Exclusive Federal Jurisdiction

The validity of the fee agreement – and thus Respondents' claim for rescission – turns on whether it is authorized under Section 10.64 and whether the New York Code may limit or define the terms under which a patent attorney who is a member of the New York bar (which Petitioner Bain is not) may accept an equity fee in return for patent legal services. Respondents' claim for rescission therefore squarely rests on the interpretation of federal patent law subject to the exclusive jurisdiction of the federal courts under 28 U.S.C. § 1338. *See Christianson*, 486 U.S. at 808-09.

Federal law requires courts to give "a broad construction to the 'relating to patents' language in Section 1338." *Jaskiewicz v. Mossinghoff*, 802 F.2d 532, 534 (D.C. Cir. 1986) (quoting *Panduit Corp. v. All States Plastic Mfg. Co., Inc.*, 744 F.2d 1564, 1574 (Fed. Cir. 1984)). Far from following this federal mandate, the trial court incorrectly determined that exclusive federal jurisdiction does not apply here, mistakenly reasoning that "this case does not sound in patent law because the 'interpretation of the patent laws *on the issues of priority and infringement are hardly at issue*.' " App. at 61a. This overly restrictive formulation

10. Petitioners acknowledge that, as patent attorneys who are members of a state bar, they are subject to discipline by that bar for acts committed during their practice, even if those acts were committed during the course of the attorney's practice before the PTO. *See Kroll v. Finnerty*, 242 F.3d 1359 (Fed. Cir. 2001). But the alleged misconduct under a state's ethics code cannot be based on conduct specifically authorized and encouraged by the federal patent laws. *Kroll*, was a disciplinary proceeding, not a civil action for contract recission and disgorgement of fees. The conduct complained of was not unique to patent practice much less sanctioned by the patent law and only the lawyers future conduct in connection with the general practice of law was in issue.

ignores this Court's "lenient standard for jurisdiction under 28 U.S.C. § 1338(a)," *U.S. Valves, Inc. v. Dray*, 212 F.3d 1368, 1371 (Fed. Cir. 2000), and runs directly contrary to a long line of decisions by this Court and the federal courts of appeals holding that exclusive federal jurisdiction is not limited to issues of patent priority and infringement, but extends to any "substantial question of federal patent law." *Christianson*, 486 U.S. at 808; *Cedars-Sinai Med. Ctr. v. Watkins*, 11 F.3d 1573, 1577-80 (Fed. Cir. 1993) (claims based on statute vesting title to inventions made in government labs to the United States, arise under the patent laws); *Franchi v. Manbeck*, 947 F.2d 631, 633-34 (2d Cir. 1991) (mandamus claims related to PTO qualifying exam arise under the patent laws); *Morganroth v. Quigg*, 885 F.2d 843, 846 (Fed. Cir. 1989) (claims relating to PTO's refusal to revive abandoned patent application arise under the patent laws); *Wyden v. Comm'r of Patents & Trademarks*, 807 F.2d 934, 936-37 (Fed. Cir. 1986) (mandamus claims related to attorney's authority to practice before the PTO arise under the patent laws); *Alco Standard Corp. v. Tennessee Valley Auth.*, 808 F.2d 1490, 1493-94 (Fed. Cir. 1986); *Dubost v. PTO*, 777 F.2d 1561, 1564-65 (Fed. Cir. 1985). If the case turns "at least in part" on the patent laws, the federal courts have exclusive jurisdiction. *Helfgott*, 209 F.3d at 1333; *see also Hunter Douglas, Inc. v. Harmonic Design*, 153 F.3d 1318, 1328-29 (Fed. Cir. 1998), *overruled on other grounds by Midwest Indus., Inc. v. Karavan Trailers, Inc.*, 175 F.3d 1356 (Fed. Cir. 1999) (en banc). Indeed, there can be no more substantial question of patent law than the interpretation and application of a regulation issued by the PTO governing the practice of patent law.

The New York Court of Appeals' refusal to acknowledge exclusive federal jurisdiction simply because Respondents omitted Section 10.64 from the complaint (App. 14a) was manifest error. The mere fact that the face of Respondents' self-serving complaint does not specifically plead or cite a statutory element of federal patent law such as the PTO Code is irrelevant to the determination of exclusive federal jurisdiction. Plaintiffs cannot avoid or defeat exclusive federal jurisdiction through

artful pleading or ignorance of the applicable law. *See Rivet v. Regions Bank of La.*, 522 U.S. 470, 475 (2000) (plaintiff may not defeat removal by failing to plead necessary federal question); *Christianson*, 486 U.S. at 809 ("Just as a plaintiff may not defeat removal by omitting to plead necessary federal questions in a complaint, so a plaintiff may not defeat § 1338(a) jurisdiction by omitting to plead necessary federal patent-law questions") (internal citations and quotations omitted); *State ex rel. Nixon v. Coeur D'Alene Tribe*, 164 F.3d 1102, 1109 (8th Cir. 1999). "Once an area of state law has been completely preempted" – like equity-based fees between inventors and their patent lawyers – "any claim purportedly based on that pre-empted state law claim is considered, from its inception, a federal claim, and therefore arises under federal law." *Rivet*, 522 U.S. at 476. Were it otherwise, fifty state courts could reach different decisions regarding the scope of Section 10.64 on the same facts. Not only would this violate the Congressional mandate embodied in the creation of the Federal Circuit to promote uniformity in the field of patent law, it would cause disarray in the field of patent law, not to mention utter confusion in the patent bar. *See, e.g., In re Indep. Serv. Orgs. Antitrust Litig.*, 203 F.3d 1322, 1322-1324 (Fed. Cir. 2000) (holding the Federal Circuit is the only appellate court having the right and obligation to determine the extent that federal patent laws preempt state law); *Midwest Indus. v. Karavan Trailers, Inc.*, 175 F.3d 1356, 1360-61 (Fed. Cir. 1999) (en banc) (emphasizing the Federal Circuit has an "obligation [to] promot[e] uniformity in the field of patent law" and a "responsibility to decide what patent law permits and prohibits").

The Court of Appeals narrowly portrays this case as one about the "ethical obligations [attorneys] must maintain in the course of their interaction with clients." App. 14a. Again, however, this is *not* a disciplinary case. *See supra* n.10. Indeed, Petitioners are not simply (here, *not even*) lawyers practicing New York law. Petitioners represented Respondents in federal patent matters, and their interaction with their clients is governed by federal law in the form of the PTO Code. That the New York

Code may have something to say about fee arrangements between New York attorneys and their non-patent clients is irrelevant. (Moreover, it is impossible to understand how the New York Code applies at all to Petitioners, who were not practicing in New York, and particularly to Petitioner Bain who is *not even a member of the New York Bar*). State courts may not simply ignore federal patent law governing the conduct of patent attorneys because it prefers to apply conflicting state law and states may not add supplements to the federal scheme. This Court and the Fifth Circuit have expressly ruled that state bar rules must yield to federal rules governing the practice of patent law. *See Sperry*, 373 U.S. at 384; *Silverman*, 405 F.2d at 411; *see also Mikohn Gaming Corp. v. Acres Gaming, Inc.*, 165 F.3d 891, 896 (Fed. Cir. 1998) (federal law must be applied where there is conflict between state commercial law and federal patent law).

Once again, these issues affect the daily prosecution of patents nationwide. If patent practitioners are to be judged in state court by some combination of federal and state ethical standards, the congressional objective of a separate patent bar (that includes non-lawyers) and a uniformly interpreted and applied federal policy and ethics code will be undermined if not nullified.

II. Binding Petitioners To A Prior Determination In A Case In Which They Were Relieved Of Liability By Court Order Is Unconstitutional

The lower court bound Petitioners to the judicial determination of an issue that had been decided, not against them, but against a third party, in the *Rhodes* action. It did so despite the fact that the *Rhodes* court had expressly ruled it would have been unfair to bring Petitioners in as actual parties for the litigation of that issue. The majority reached this anomalous result on the basis of its holding that defendants were in privity with the losing party in *Rhodes*, a determination largely grounded upon Petitioners' and Rhodes' allegedly common interest in the validity of the fee agreement. App. 9a-11a.

Although the existence of privity is primarily a question of state law, the application of privity for preclusion purposes is constrained by federal due process requirements. *See, e.g., Richards*, 517 U.S. at 797-802 (holding that "there are clearly constitutional limits on the 'privity' " concept and determining the application of *res judicata* by the state court in that case to have been a violation of due process); *Aldrich v. Aldrich*, 378 U.S. 540, 543 (1964) ("[I]f the judgment is binding upon him, it is also binding on those whom Florida law considers to be in privity with him, so long as Florida does not seek to bind those who cannot be bound consistent with due process."). As the dissent eloquently explains, the lower court's broad expansion of offensive collateral estoppel contravenes due process of law as guaranteed by the Fourteenth Amendment. App. 33a-39a.

A. The Constitutional Standard: Issue And Claim Preclusion Raise Due Process Concerns Of The Highest Nature

It is a fundamental principle of American jurisprudence that "everyone should have his own day in court." *Richards*, 517 U.S. at 798 (internal quotation marks omitted); *accord Hansberry v. Lee*, 311 U.S. 32, 40 (1940). This principle is embedded in the due process guarantees of the Fourteenth Amendment to the United States Constitution, as this Court has repeatedly recognized. *See, e.g., Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 327 n.7 (1979); *Postal Tel. Cable Co. v. City of Newport*, 247 U.S. 464, 476 (1918).

For these constitutional reasons, this Court has established stringent requirements for the application of *res judicata* and collateral estoppel. This Court has expressly instructed that due process prohibits courts from binding a litigant to an adverse determination made in a prior proceeding in which he was not actually a party, or at least in privity with a party. *See Provident Tradesmens Bank & Trust Co. v. Patterson*, 390 U.S. 102 (1968); *Postal Tel. Cable Co.*, 247 U.S. at 476. This rule flows squarely from the fundamental principle that a party can be precluded

from litigating only if already given "a full and fair opportunity to litigate" the claim or issue in the prior action. *Johnson v. De Grandy*, 512 U.S. 997, 1005 (1994); *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461, 480-481 (1982).

For these reasons, this Court has often examined the constitutional underpinnings of claim and issue preclusion. Almost by definition, improper application of these doctrines is a denial of due process. Improper *articulation* of these principles by a state's highest court, however, threatens widespread violations of due process and resulting damage.

Here the Court of Appeals committed two significant errors in its application of *res judicata*. *First*, the Court mistook (limited) commonality of interest as "privity" sufficient to preclude Petitioners from presenting their case. *Second*, the Court applied *res judicata* into the teeth of a court order in the prior action that relieved Petitioners of any liability (or interest) in that prior action.

B. *Richards v. Jefferson County*: Common Interest Is Insufficient To Create Privity

Due process limits the extent to which a state court can bind non-parties to prior judgments by preclusion principles. In *Richards*, this Court reiterated that due process limits a state court's power to categorize parties as privies for purposes of preclusion law and explained:

> The limits on a state court's power to develop estoppel rules reflect the general consensus in Anglo-American jurisprudence that one is not bound by a judgment in personam in a litigation in which he is not designated as a party or to which he has not been made a party by service of process. This rule is part of our deep-rooted historic tradition that everyone should have his own day in court. . . .

517 U.S. at 798 (internal quotations and citations omitted).

The Court recognized the privity exception to the general rule that non-parties may not be bound by a prior judgment, but expressly warned that "there are clearly constitutional limits on the 'privity'

exception." *Id.* In *Richards*, the Alabama Supreme Court relied on privity to preclude a set of taxpayer-plaintiffs from litigating the constitutionality of a county tax in a suit against Jefferson County. *See Jefferson County v. Richards*, 662 So. 2d 1127, 1129-30 (Ala. 1995). Noting that the *Richards* plaintiffs were asserting claims identical to those that had been unsuccessfully brought by the City of Birmingham and other taxpayers against the county in a prior action, the Alabama Supreme Court concluded that taxpayers were in privity with the city and prior taxpayers. *See id.* at 1128, 1130. As this Court explained, the Alabama Supreme Court applied privity-based preclusion on the theory that the plaintiffs in the prior lawsuit had "adequately represented Petitioners because their respective interests were essentially identical." *Richards*, 517 U.S. at 796.

This Court unanimously reversed, holding the Alabama Supreme Court's broad application of privity-preclusion infringed the *Richards* plaintiffs' due process rights. Importantly, as the Seventh Circuit has noted, the *Richards* Court "squarely rejected the Alabama Supreme Court's conclusion that *res judicata* could apply because the later plaintiffs were adequately represented in the earlier suit, not because it disagreed with the Alabama court's assessment of the nature of the earlier representation, but because this fact alone was not enough." *Tice*, 162 F.3d at 972.

Analyzing the case before it, the Court ruled that the following factors compelled the conclusion that the Alabama Supreme Court's application of *res judicata* was so extreme as to violate due process:

- *First*, the *Richards* petitioners never received notice that the earlier case "would conclusively resolve their legal rights." (Here, Petitioners *prevailed* in opposing a belated motion to bring them into the case.)
- *Second*, "their pleadings did not purport to assert any claim against or on behalf of any nonparties." (Likewise here, until the motion to amend was filed.)

- *Third*, "the judgment [in the prior action] did not purport to bind any [] nonparties." (Likewise herein.)

Richards, 517 U.S. at 799. Thus, this Court unanimously held that:

> As a result, there is no reason to suppose that the [prior] *Bedingfield* court took care to protect the interests of Petitioners in the manner suggested in *Hansberry*. Nor is there any reason to suppose that the individual taxpayers in *Bedingfield* understood their suit to be on behalf of absent county taxpayers. Thus, to contend that the plaintiffs in *Bedinfield* somehow represented Petitioners, let alone represented them in a constitutionally adequate manner, would be "to attribute to them a power that it cannot be said that they had assumed to exercise."

Id. at 802 (quoting *Hansberry*, 311 U.S. at 46).

The factors this Court relied upon in holding that due process of law had been denied in *Richards* apply equally or more powerfully to Petitioners here. Most important, Petitioners were never put on notice that their rights would – or even might – be conclusively resolved by the prior litigation. Quite the opposite: Petitioners were told – by court order no less – that no claims against them were being, or could be, litigated against them in the *Rhodes* action. App. 72a-74a.

Following this Court's decision in *Richards*, several federal circuit courts have made clear that a court cannot apply privity-preclusion solely on the basis of an identity of interests, however close, between a current party and a party to a prior lawsuit. *See, e.g.*, *Becherer*, 193 F.3d 415 (en banc); *Tice*, 162 F.3d 966. By ignoring this rule, the New York courts prohibited Petitioners from bringing their own unique, personal and separate defenses such as equitable estoppel, waiver and novation which were not and could not have been raised in the *Rhodes* action.

The Sixth Circuit's opinion in *Becherer* illustrates the conflict between the expansive preclusion law adopted by the majority below and the permissible boundaries of privity-preclusion as

articulated by federal circuit courts. The district court in *Becherer* found a second group of plaintiffs (the "Florida plaintiffs") to be privies with a prior set of plaintiffs (the "Becherer plaintiffs") on the basis of a relationship far closer than the relationship between Rhodes and Petitioners, but the Sixth Circuit reversed.

The *Becherer* Case:	**The Instant Case:**
• Both sets of plaintiffs were investors in a Florida hotel development. *Becherer*, 193 F.3d at 418.	• Rhodes and Petitioners were parties to the same original fee arrangement, but that agreement underwent fundamental revisions over time. App. 1a-2a.
• Each of the Florida plaintiffs was a member of the Association of Unit Owners, which had "authorized, financed and controlled the investigation and prosecution of the Becherer plaintiffs' lawsuit." *Id.* at 420.	• Petitioners had no involvement in the authorization, finance or control of the *Rhodes* action. Indeed, Petitioners were on opposite sides of *Rhodes* and served as patent counsel for Respondents for *eight years* while the *Rhodes* action was litigated. App. 119a.
• "Florida plaintiffs' counsel, Thomas Grady, told a Florida court in 1990 that the resolution of the *Becherer* case in the Eastern District of Michigan would determine the rights of his clients in the Florida case." *Id.* at 420.	• Petitioners never acknowledged that they would be bound by the *Rhodes* action. Indeed, the *Rhodes* court affirmatively put Petitioners on notice that their interests were *not* in jeopardy in the *Rhodes* action. App. 73a.
• "[Florida plaintiffs' counsel] acknowledged that the Florida plaintiffs' interests were congruent to those of the AUO." *Id.* at 421.	• Petitioners never had the same interests as *Rhodes* nor ever hinted at any such common intent; in fact, they opposed the filing of Rhodes' lawsuit. App. 1a-5a.

The *Becherer* Case:	The Instant Case:
• "22 Florida plaintiffs signed affidavits requested by [counsel for the Becherer plaintiffs] opposing defendants' motion for summary judgment." *Id.* at 420.	• Petitioners never signed a single affidavit supporting any motion by *Rhodes*. App. 1a-5a.
• "The Becherer plaintiffs claimed to adequately represent the Florida plaintiffs' interests." *Id.* at 421.	• Rhodes never claimed to represent Petitioners. App. 1a-5a. Rhodes could not and did not raise defenses available only to Petitioners.
• "[T]he Florida plaintiffs improperly maneuvered in order to avoid the potential effects of *res judicata*." *Id.* at 421.	• The *Rhodes* court affirmatively put Petitioners on notice that their interests were *not* in jeopardy in the *Rhodes*. App. 73a.

Accepting the district court's factual findings as true, the Sixth Circuit concluded that due process did not permit the Florida plaintiffs to be bound by the determination rendered against the Becherer plaintiffs. Focusing upon the adequate/virtual representation theory, which had been the district court's primary basis for finding privity, the *Becherer* court explained that "adequate representation" denotes an express or implied *legal* relationship in which parties to the first suit are *accountable* to non-parties who file a subsequent suit raising identical issues." *Id.* at 424 (quoting *Benson and Ford, Inc. v. Wanda Petroleum Co.*, 833 F.2d 1172, 1175 (5th Cir. 1987)) (internal quotation marks omitted) (emphasis in original). The *en banc* court concluded that, even on the basis of the extensive set of facts outlined above, "there is no evidence that the Florida plaintiffs here could have held the Becherer plaintiffs, the [Association of Unit Owners] or [their attorney] legally accountable for the result of the *Becherer* litigation." *Id.* Since they could not, the Sixth Circuit concluded that the district court's application of privity-preclusion conflicted with this Court's holding in

Richards and thus deprived the Florida plaintiffs of their due process rights. *See id.* at 427. In the present case, it is clear that Rhodes was accountable to no one but Rhodes.

In *Tice*, the Seventh Circuit noted that *Richards* re-affirmed the "importance the Court attaches to assuring each person his or her own day in court." *Tice*, 162 F.3d at 972. The *Tice* court interpreted *Richards* as supporting "[a] proper functional analysis of privity, focusing on the general question whether the earlier parties were in some sense *proper agents* for the later parties." *Id.* at 971 (emphasis added). A party can be precluded based upon another parties' earlier litigation if, and only if, the facts indicate that the earlier party was an *agent* for the later party. *See id.* at 971-72. In *Tice*, the Seventh Circuit allowed a group of American Airlines pilots to assert a claim under the Age Discrimination in Employment Act even though a different group of pilots and the Equal Employment Opportunity Commission had each previously asserted, unsuccessfully, similar challenges to the same American Airlines policy in separate prior actions. *See id.* at 973-74. It found that there was no basis upon which the first set of pilots could said to have been agents for the *Tice* plaintiffs, because there was no relationship between the two sets of plaintiffs other than that they were all American Airlines pilots. Similarly, the EEOC had not acted as the actual representative of the *Tice* plaintiffs.

In the instant case, the New York Court of Appeals based its privity finding principally upon the fact that Petitioners and Rhodes were co-signatories to a fee agreement entered into in 1974 with Respondents, and thus had "rights to receive payments . . . coextensive with Rhodes." App. 10a. This legal ruling, however, is in direct conflict with the basic message of *Richards*, *Becherer* and *Tice*. Thus, the fact that Petitioners and Rhodes all had an interest in the original fee agreement (which was changed repeatedly in the ensuing years) is not, under the due

process holdings of *Richards*, *Becherer*, and *Tice*, sufficient to create privity and to bind Petitioners to the rulings of the *Rhodes* action.[11]

In its only footnote, the Court of Appeals majority strives to insulate its decision from review by stating that a "confluence of factors" was dispositive to its holding, listing Petitioners' relationship with Rhodes, their involvement in the *Rhodes* action, their awareness of issues to be decided and their so-called tactical decisions. App. 13a. n.1. However, each of the factors identified was present to a similar extent, or even greater, in *Richards, Becherer* and *Tice*.[12] None of those cases found privity constitutionally permissible. Thus, the lower court's opinion stands in unavoidable conflict with the due process analysis in *Richards*, *Becherer* and *Tice*.

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11. None of the traditional grounds giving rise to privity were present in this case. The most traditional form of privity occurs where one party's rights are derivative upon another's. *See Richards*, 517 U.S. at 798. A second established form of privity is where one party exercised a degree of control over another party's litigation of a prior action. *See* Restatement (Second) of Judgments § 39.

The majority below did not cite either of these forms of privity, and there is no tenable basis to conclude that either apply. Petitioners' rights were in no way conditional upon or derivative of Rhodes' rights in the prior litigation. The fact that Petitioners and Rhodes were law partners until 1981 does not alter this conclusion. Indeed, it is well established in New York (and elsewhere) that there is no privity when the relationship which allegedly creates privity terminates prior to the dispute. *See, e.g.*, *Comi v. Breslin & Breslin*, 257 A.D.2d 754 (3d Dep't 1999). This is especially so where, as here, the relationship between Rhodes and Petitioners had turned openly hostile and acrimonious by the time that Rhodes commenced the *Rhodes* action (six years after his partnership with Petitioners terminated). Neither is there a scintilla of evidence that defendants even participated in – much less coordinated or controlled – Rhodes' litigation of his case.

12. Moreover, the *Rhodes* opinion itself established that Petitioners and Rhodes had widely divergent interests, finding that Rhodes had engaged in activities contrary to Petitioners' interests. App. 87a-88a.

C. The Offensive Use of *Res Judicata* To Bind Petitioners To The *Rhodes* Decision – Particularly Where The *Rhodes* Court Expressly Relieved Petitioners Of Potential Liability – Directly Conflicts With This Court's And The Federal Courts Of Appeals' Due Process Jurisprudence.

This case does not involve the typical defensive use of *res judicata* or collateral estoppel. Rather, Respondents have persuaded the Court of Appeals to apply *res judicata* offensively to avoid a trial – and even to preclude discovery – and to summarily award millions of dollars in damages against two individuals nearing the end of their professional careers who have never had their day in court. This *offensive* use of preclusion raises fundamental fairness and due process concerns that implicate constitutional rights of the first order. *See Parklane Hosiery*, 439 U.S. at 329-31 (warning that offensive collateral estoppel should be allowed sparingly). And the lower court's *vicarious* offensive use of privity-preclusion strikes at the very heart of a litigant's right to due process of law.

The fundamental requisite of due process is the right to notice and a full and fair opportunity to be heard. *See Cleveland Bd. of Ed. v. Loudermill*, 470 U.S. 532, 542 (1985). Although Petitioners were eventually joined in *Rhodes* as defendant-beneficiaries in the caption of that action, all claims in that action were solely between Rhodes and Respondents. Petitioners received the first and only notice of a claim being asserted against them when Respondents moved on the eve of trial to amend their counter complaint. They acted immediately to oppose the motion to amend, and they prevailed. Thus, the trial court in the instant action issued an order that denied that motion and *relieved Petitioners of liability in the Rhodes case*. In effect, Petitioners were put on notice that the claims against them were *not* going to be determined in *Rhodes*.

This Court recognized long ago that the right to be heard has little value without a requirement that a party be given notice of the claims being asserted against him. *See Mullane v. Central*

Hanover Bank & Trust Co., 339 U.S. 306, 314 (1950). How could Petitioners have reasonably been expected to mount a meaningful defense without being informed – even by minimal notice pleading requirements – of what the claims against them were? Indeed, this is the *opposite* of notice: Petitioners were relieved of liability in *Rhodes*, and told in effect that they could go home. This is also the *opposite* of *res judicata*: Petitioners *prevailed* in the only part of the *Rhodes* case in which they participated, the only part that is pertinent to the present claims.[13]

Petitioners believe that their reliance on the denial of the motion to amend was entirely reasonable. They "went home," as it was their right to do. Petitioners believe that the New York courts' later contradictory rulings, which bind Petitioners to the ruling made after Respondents' motion to amend was denied, are not just unconstitutional, but absurdly so.

Compounding this lack of notice, or notice-opposite, was the absence of any opportunity to conduct discovery. As Judge Levine explained below:

> New discovery would have been vital to all parties and especially [Petitioners], if they had had been joined on the counterclaim, because their affidavits herein show that they had extensive dealings with [Respondents] separate from Rhodes, both before and after his withdrawal from the law partnership. .
>
> . .
>
> Surely, the total absence of participation [in the *Rhodes* action], including the entire loss of opportunity for discovery, occasioned by the *Rhodes*

13. Several courts have held that the denial of a motion to amend bars a plaintiff from re-asserting those same claims in a subsequent action. *See, e.g.*, *Landscape Props., Inc. v. Whisenhunt*, 127 F.3d 678, 683 (8th Cir. 1997) ("It is well settled that denial of leave to amend constitutes *res judicata* [against plaintiffs] on the merits of the claims which were the subject of the proposed amended pleading."); *EFCO Corp. v. U.W. Marx, Inc.*, 124 F.3d 394 (2d Cir. 1997); *King v. Hoover Group, Inc.*, 958 F.2d 219, 222-23 (8th Cir. 1992); *Huck v. Dawson*, 106 F.3d 45, 49-50 (3d Cir. 1997); *Walton v. Eaton Corp.*, 563 F.2d 66 (3d Cir. 1977).

> trial court's refusal to grant [Respondents'] motion to join defendants on their counterclaim, must also be a denial of a full and fair opportunity to litigate.

App. 22a-23a.

Because Petitioners were not given (i) notice of claims being asserted against them in the *Rhodes* action, (ii) any opportunity, ever, to take discovery on such claims or (iii) an opportunity to be heard on the merits of those claims, the due process difficulties are manifest. When compounded by the message sent by the *Rhodes* court when it denied the motion to amend, those difficulties become basic and manifest injustice.

Having been freed of liability and litigation in *Rhodes*, Petitioners were bound retroactively to the judgment in *Rhodes*, as if they had actually litigated that case. This order resulted in an outcome far more prejudicial than if Respondents' eve-of-trial motion in *Rhodes* had been granted. Here, Petitioners were afforded no chance to defend themselves. Indeed, they were told by the *Rhodes* court itself that their rights would not be adjudicated in that action. Then they discovered, to their understandable dismay, that their rights had *already been* adjudicated. Due process mandates that Respondents' claims against Petitioners be allowed to stand or fall on their own, unique merits in a forum where Petitioners are there to defend themselves. The New York courts have done everything but afford due process to Petitioners.

CONCLUSION

For the foregoing reasons, Petitioners respectfully submit that a writ of certiorari to the New York Court of Appeals should be granted and that this case should be heard by the Supreme Court on the issues of law raised by this petition.

Respectfully submitted,

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